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EXHIBIT 32

Statement of E. Linwood Tipton
Chairman & CEO
The Tipton Group, Inc.
Washington, DC

Before the USDA hearing on
Proposed Amendments to Tentative Marketing Agreements and Orders
Seeking to Amend the Class I Fluid Milk Product Definition

Presented on behalf of:

Bravo! Foods International Corporation
Lifeway Foods, Inc.
PepsiCo
Starbucks Corporation
Unilever United States, Inc.

June 20, 2005

Sheraton Station Square Hotel
Pittsburgh, Pennsylvania

Docket No. AO-14-A73, et al.; DA-03-10

32

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The companies on whose behalf I am appearing take the following positions relative to the issues raised in this hearing.

I. They support continuation of the requirement that a product must contain by weight at least 6.5 percent nonfat milk solids to be included in Class I.

II. They support the classification of yogurt and kefir in Class II, whether in liquid drinkable form or a more viscous spoonable form, and whether combined with juices or other foods or not.

III. They support continuing to exclude from the Class I definition "formulas prepared for infant feeding or dietary use (meal replacement) that are packaged in hermetically-sealed containers."

IV. They support adding the following types of products to be excluded from the Class I definition, when packaged in hermetically-sealed containers: formulas for snack replacement; high protein drinks; beverages that contain alcohol and are licensed by the Treasury Department; and packaged milk products formulated and labeled for animal use.

V. They oppose all proposals not consistent with the above positions including:

   a. The reduction or elimination of the 6.5 percent minimum nonfat solids standard;
   b. The addition of a protein standard along with the 6.5 percent nonfat milk solids standard, or the replacement of the 6.5 percent standard with a protein standard; and
   c. The inclusion of whey in applying the 6.5 percent nonfat solids minimum.

VI. They oppose using as a basis for classifying products in Class I -- "any products containing milk or milk products – that are intended to be used as a stand-alone beverage".

<u>Coping with Driving Forces of Change</u>

Before proceeding to testify on the issues involved in specific proposals, I want to provide the context in which any decisions coming from these proceedings should be made.

The Federal milk orders classified pricing system is confronted with unstoppable driving forces of change that must be recognized and addressed in any decisions coming from this proceeding. We believe the facts will support and justify a continuation of the current classification criteria with some added clarity and the specific exclusions from Class I of a few specific formulas and products that do not compete with beverage milk, but do nevertheless, utilize significant quantities of dairy farmers milk and dairy-derived ingredients.

Among the driving forces of change are:

- A continuous decline in fluid milk consumption in face of strong competition from a broad range of other alternative beverages such as water, juice, soft drinks, teas, sports drinks and many new beverage market entrants. The exponential growth of competitive alternative beverages, the substantial advertising and promotion budgets of highly branded beverages, and changing concepts of "healthy drinks" are forces to be recognized and addressed. The availability of substitute and alternative beverages has resulted in milk sales being much more responsive to price changes than in earlier years.

- Quantum advances in ingredient technology often make fractionations and derivatives of milk's components more functionally desirable than the base component from which it was developed. Whey protein technology has spawned a growing global market for various whey protein products, many of which are now used in sports drinks and other high energy drinks and products. The forces of ingredient technology make it increasingly difficult to draw a distinction about when a beverage might be considered a dairy product by consumers and when it would not. The competitive set for milk is not dependent on whether the competing product contains a modicum of some dairy derived ingredient. Soft drinks with no added dairy derived ingredients are the most potent competitive alternatives and water and juices are taking market share away from milk as well. However, USDA has no authority to regulate these highly competitive alternative products. USDA needs to be very careful and avoid creating situations that will make the use of non-dairy ingredients more attractive than dairy-derived ingredients.

USDA should apply an "acid test" to all proposals and suggestions offered during this proceeding. This test is whether the proposal or suggestion increases the demand for the product in question, and will it increase or decrease the demand for milk-derived ingredients. Proposals or suggestions that fail this test should be rejected. USDA should include among its objectives and goals: permitting and encouraging development of drinkable products that contain dairy ingredients and provide specific benefits to consumers for specific purposes and uses; are available to consumers in outlets and distribution channels where currently milk is often not available; and are positioned and formulated to provide specific nutrients or nutritional profiles to meet specific groups of consumers' needs.

The dairy and food industries and USDA should be pursuing courses of action that will expand the consumption of milk and drinkable products that contain dairy-derived ingredients. This is the course for expanding and growing the market for dairy farmers' milk and its components. However, we fear that some are approaching this proceeding with a desire and intent to erect barriers, create difficulty and generally, make it more difficult for non-traditional drinkable products containing dairy-derived ingredients to be marketed.

The reason for price classification. Although a number of potential reasons have been offered over the years in support of classified pricing, only one really captures the truth. Price classification under Federal milk orders was designed to obtain higher revenue to producers than they would have received without classified prices. However, there now exists substantial doubt that classified pricing is or can in fact enhance producer revenues. Increasingly, the loss of revenue from lost sales resulting from the higher Class I price is offsetting the additional revenue generated from the higher price. In fact, new price responsiveness measures (elasticities) show that the sales of many products included in the Class I category actually produce less revenue for dairy farmers than they would if included in a lower price class. Among the Class I products to which this statement applies are:

- Flavored milk in gallon containers;
- Both white and flavored milks in half gallon containers; and
- Fat free milk in gallons and all fat levels of milks in half gallons, including whole milk.

Federal milk order classified pricing is a government regulatory form of a general economic pricing theory known as "price discrimination". This economic business caption --- "price discrimination" --- applies to the process of charging different prices in separate markets, i.e. one higher and one lower, for identical products, which is what Federal milk orders do. Milk used for drinking (beverage milk/Class I) is priced higher than milk used to produce other products such as butter, cheese, and other so called manufactured dairy products, <u>although the milk used in all the products is the same and is used in each of the classes interchangeably</u>.

As already stated, the purpose of classified pricing is to generate more total revenue for dairy farmers than would be possible if all the product (milk) was sold at one price. However, in order to generate more total revenue two conditions must be present. There must be a difference in how customers in the different markets respond to the prices, and the lower-priced product cannot be substituted for the higher priced product.

<u>**First, foremost and basic to the whole concept, there must be a difference in how customers respond to the differing prices in the separate markets.**</u> If customers in one market accept the higher prices without significantly decreasing consumption, or at least not changing their consumption as much as they would in the other market, more total revenue can be generated by increasing the price in the markets where the response is less and charging lower prices in the markets where customers react more negatively to the higher prices.

This economic principle is the basic tenet of Federal milk marketing orders classified pricing. The government holds that total dairy farmer revenues can be increased by charging a higher price for milk used for beverage milk (Class I, market # 1) than milk used for other purposes (manufactured dairy products/market # 2) because, they contend, consumers will decrease their consumption of beverage milk less than they will decrease their consumption of other products if those prices were higher. This, we submit, is unlikely in today's beverage market and especially in the case of certain products that do not meet the federal standards of identity for milks, but contain some dairy-derived ingredients and are often positioned for specific segments of the market.

<u>**The second necessary rule for successful price discrimination is that the lower priced product cannot be substituted for the higher priced product.**</u> Why would anyone pay the higher price, at least for very long, if the lower-priced product were available? It is raw milk of the same quality, healthfulness, nutritional content, etc. It is indistinguishable. It is the same milk, often from the same farm, some is simply used for beverage milk and the other is used for other products. No one would pay the higher price in such a circumstance -- unless forced to do so. To meet the criteria that the lower-priced milk cannot be substituted for the higher priced milk, the Federal Government has become the "enforcer". Its extensive,

complicated and heavily enforced rules prevent the lower-priced milk from being substituted for the higher-priced milk. The Government traces virtually every pound of milk from the farm to the consumer at an enormous cost per year. Additionally, the costs incurred by dairy companies to create and maintain detailed records of how the milk is used is also very high.

Is the first criteria for price discrimination/classified pricing being met? The answer is probably not, but even more importantly, is it even in the interest of dairy farmers to continue this antiquated 72-year-old federal program of price discrimination? The only reason to keep a classified pricing system is if it in fact enhances producer revenues. There is now substantial doubt that it does.

If producers or the government did not think price discrimination/classification increased producer revenues, it would not be used. But now new data and the greatly changing beverage market raises very serious doubts that dairy farmers get any more revenue by pricing raw milk in different classes. The new data reveals that for many Class I products the higher Class I prices result in lower total revenues for that product because of the large decrease in sales.

Total sales of fluid milk have declined from the previous year in 6 of the past 8 years and at the end of 2004 were 3 percent below 1999's sales, and per capita sales of fluid milk have declined every year since 1983 at a rate of about 1 percent per year. This is not a new trend. Fluid milk sales have simply not kept pace with the rest of the beverage market. Fluid milk is loosing market share consistently and regularly. Competing products are gaining share daily. Bottled water sales now exceed milk sales, as does coffee, and soft drinks. Milk and beer sales are about the same. New consumer responsiveness data shows that most beverage milk products are considerably more price responsive than previously assumed and many are even more responsive to price changes than the lower priced products in Class II and III.

Price elasticities are the traditional measure of price responsiveness. In the context of this testimony, it should be noted that in order to increase revenues by practicing price discrimination/classification, there must be a difference in the elasticities for the higher priced milk and the lower-priced milk. Currently, there is a huge discrepancy between historical measures of price elasticities and more recent data. USDA, in its most recent report to Congress dated July 2004, on the nation's generic promotion programs contended that the retail price elasticity for fluid milk was a –0.098, meaning a 1.0 percent increase in the retail price of fluid milk is estimated to reduce per capita sales of fluid milk by only 0.1 percent. This differs greatly from two recent studies. These new analyses show a very wide range of elasticities for various fluid milk products and even find a composite elasticity for fluid milk that is nearly 8 times higher than that reported by USDA.

Dr. Oral Capps, Jr., of Texas A&M University concludes that: "Historically there has been a void of information with respect to elasticities of demand for fluid milk products. Most of the information available was based on analysis of all milk. Importantly, these analyses often did not take into account the competitive forces at work in the marketplace, where milk comes in many forms and package sizes. In fact, in a recent report to Congress dated July 1, 2003, the own price elasticity of demand for fluid milk was reported to be -0.085 (Note: the July 1, 2004 report estimates -0.098). The marketplace reality, according to this project, is that for individual milk products demand is not nearly so inelastic, and for many products is in fact elastic." (presentation by Dr. Oral Capps, Jr., Southwest Dairy Marketing Endowed Chair, Texas A & M University, Managing Partner, Forecasting and Business Analytics, LLC, in January 2004, at the International Dairy Foods Association's Dairy Forum in Boca Raton, Florida)

To illustrate his point, Dr. Capps found that the elasticity for gallons of white milk was -0.5597 (basically a 1 percent increase in price results in nearly 0.6 percent drop in consumption – still inelastic but 6 times less inelastic than USDA reports); for gallons of flavored milks Dr. Capps reports an elasticity of -1.2092 – quite elastic; for half gallons he reports -1.7383 for white milk and -2.1063 for flavored milk – both highly elastic. (Note: When the elasticity exceeds one an increase in price will decrease consumption more than proportionate to the price increase and total revenues will be less.) Dr. Capps found the demand for carbonated soft drinks, bottled water, and juices/drinks were all quite elastic also. He also found that carbonated soft drinks are strong substitutes for both white and flavored milk. He found that the elasticity of branded milk in gallons was nearly 1 for 1, i.e. a 1 percent change in price brought a 1 percent change in sales in the opposite direction; private label milk in gallons was about 1 to 0.6. In all cases, the elasticities were found to be less inelastic than previously believed, and in many cases, they were elastic. Dr. Capps calculated elasticities for milks of differing fat levels and also found the individual elasticities to be much greater than previously reported. (presentation by Dr. Oral Capps, Jr., Southwest Dairy Marketing Endowed Chair, Texas A & M University, Managing Partner, Forecasting and Business Analytics, LLC, in September 2004, at BevExpo in Tampa, Florida)

Dr. Leigh Maynard, at University of Kentucky, using weekly data similar to that used by Dr. Capps but from an earlier time period found similar results. (Maynard, L.J. and Dr. Liu "Fragility in Dairy Product Demand Analysis", American Agricultural Economics Association annual meeting, Nashville, TN, August 1999)

As noted previously, Class I milk sales have been in decline for many years. <u>One has to raise the question as to whether continuing this system might be a serious error in public policy</u>. It seems entirely likely that with the burgeoning introductions of alternative drinks and competing beverages that consumers are much more responsive to milk prices than they were for decades past. Additionally, it seems totally logical that consumers do not perceive all Class I products to be equal in satisfying their needs, and therefore, react differently to prices in making decisions. <u>Maybe</u>, flavored milk sales have not grown as significantly as many may have expected because the elasticities are high (-1.2 for gallons and -2.1 for half gallons), or maybe these higher elasticities apply to all smaller size packages. I think this may well be the case.

<u>Clearly, extending Class I pricing to beverages that are not milk under the state and federal rules, but contain only limited amounts of milk-derived ingredients and/or drinkable products that have not heretofore been included in Class I is not appropriate based on what has happened to fluid milk sales. USDA has an obligation to producers, processors and consumers to thoroughly study and evaluate the changes that are occurring in the beverage market and whether its policy of charging a higher price for all milks consumed as beverages really helps dairy farmers, or whether changing the rules to include still more products which are not even milk is dairy farmers best interest.</u>

Additionally, USDA needs to seriously evaluate whether dairy farmer revenues will be increased or decreased if the Class I definition is changed to encompass beverages that contain only small amounts of dairy-derived ingredients. We believe dairy farmer revenues are more likely to be reduced than increased, and the demand for the components of milk will be reduced also.

Drs. Charles Nicholson, Mark Stephenson and Andrew Novakovic, professors at the Department of Applied Economics and Management at Cornell University, Ithaca, New York, have modeled the market dynamics of introducing new milk-based beverages. They conclude that there is little net additional revenues to be generated for dairy farmers by classifying these new milk–based beverages in Class I. We believe this is the case also. Efforts to capture more products containing less than 6.5 % nonfat milk solids in Class I should be rejected.

Protectionist Actions will Not Counter Basic Forces of Competition

Although there is growing evidence that it may no longer be in dairy farmers' best interest to have classified milk pricing that is not an issue before this proceeding. We have provided extensive elasticity data related to fluid milks to make the point that USDA should not adopt new rules to extend classified pricing to new products that contain limited amounts of milk-derived ingredients because they are perceived to be competitive with Class I milk. To attempt to extract a Class I price on the small amount of milk-derived ingredients contained in coffee drinks, or juice and milk or yogurt blends is a substantial overreach and can only be viewed as a protectionist action. The protectionist advocates believe that classifying these type products in Class I will deter their development and make them less competitive with milk, thereby increasing producer revenues from beverage milk. It is not based on sound economic analysis. We believe dairy farmer revenues will likely be reduced by such protectionist action.

If such actions are taken by USDA, it is highly likely that the products that now contain some dairy-derived ingredients will be reformulated to minimize, if not eliminate, milk-derived ingredients by substituting non-milk ingredients, such as soy. The technologies are now readily available to make non-dairy ingredients fulfill functions similar to those of dairy-derived ingredients. Not only are class price issues driving food formulators to use non-dairy ingredient sources, but also the record keeping and reporting requirements and presenting records for audits by market administrators are added burdens that many food processors would prefer to avoid. This is another incentive to use non-dairy ingredients.

Additionally, the Food and Drug Administration, through its Federal/State Cooperative Milk Program, is considering changes to its dairy-specific health and sanitary inspection programs so beverages that contain some dairy-derived ingredients and are similar to milk in their use, would be subject to FDA's "Grade A" milk requirements. This would limit dairy ingredients used in such products to those meeting the "Grade A" inspection requirements, which from a practical standpoint, would eliminate use of many imported ingredients that are now very widely used, as they do not meet FDA's "Grade A" requirements. This could include casein and caseinates, concentrated proteins and other fractionated components, and nutrients contained in milk including some that are not available in significant quantities from domestic producers.

This is yet another incentive for food formulators to use non-dairy ingredients in these new products. Higher costs, more recordkeeping and administrative burdens, and special regulatory inspection requirements are likely to reduce the use of dairy ingredients in these type products again leaving less net revenues for dairy farmers.

USDA Has an Obligation to Avoid Overreacting

There are a number of new products containing some milk-derived ingredients that have been introduced to the market in the past couple of years that have fallen short of food processors' goals and expectations. Some have been withdrawn from the market. There are no beverages containing under 6.5 percent nonfat solids that have gained significant share of the market.

Among some of the products that have received a lot of press in the dairy industry are Nestlé ***Choglit*** (no longer on the market), Coca Cola's ***Swerve*** (only limited distribution), Cadbury's ***Raging Cow*** (only limited distribution), Atkins' ***Advantage*** Shake (only limited success); and several brands of Smoothies, a blend of juice, kefir and/or yogurt.

Only Starbucks' ***Frappuccino*** has lasted and obtained limited market penetration. However, ***Frappuccino*** is not a product that competes with or is substituted for milk. Nearly 75 percent of ***Frappuccino*** is consumed as an "am" or "pm" snack. It contains less than 6.5 percent by weight of milk-derived ingredients. It is not positioned in the market place as a competitive alternative to milk. The top four reasons cited by consumers as to why they buy this product is that it is "portable", it is an "indulgence/a treat", it is a "change of pace", and it is "fun to drink". It is most frequently consumed in a vehicle, with consumption at home placing third. It is displayed in the non-carbonated beverage section of the soft drink aisle or the cold case of most grocery stores. It is clearly a snack product and not an alternative to milk beverage.

Another product, Cadbury's ***Yoo-hoo,*** has been on the market for many years but has only achieved meager penetration. In fact, the 6.5 percent standard was inserted primarily to exclude this product from Class I.

USDA has a long history of responsibly addressing issues under Federal milk orders that reflect major changes in markets or operations and has avoided making significant changes to the program in response to short-term market phenomena. Making a sea change decision on this issue at this time is unwarranted and premature.

<u>The 6.5 Percent Nonfat Solids Requirement</u>

The companies on whose behalf this statement is made support the continuation of the 6.5 percent nonfat solids requirement currently contained in the orders with some added clarity as to how it is to be administered.

The USDA decision that first contained the 6.5 percent nonfat milk solid standard is instructive:

> *"The 6.5 percent nonfat milk solids standard is used to exclude from the fluid milk product definition those products which contain some milk solids but which are not closely identified with the dairy industry, such as chocolate flavored drinks in "pop" bottles.*
>
> *These composition standards are chosen so as to conform as closely as possible to the water, solids and butterfat content of those products specifically listed in the fluid milk product definition, i.e. the traditional milk beverages. It is intended that these standards apply only to milk products, and only to such products that are being marketed for consumption in fluid form. ---*
>
> *<u>In determining whether or not a milk product in fluid form falls within the composition standards of the fluid milk product definition, such standards should be applied to the composition of the finished product in its finished form, not to the composition of the product on a skim equivalent basis</u>. (emphasis added) A new product not intended for beverage use might contain in its finished form somewhat more than the maximum total solids specified for a fluid milk product under the adopted composition standards. On this basis, the product would not fall within the fluid milk product definition. Application of the composition standards to this product on a skim equivalent basis, however, could result in the product meeting such standards and thus being defined as a fluid milk product.*
>
> *As pointed out by producers in their exceptions, applying the compositions standards to products in the form in which marketed could exclude from the fluid milk*

product definition a new concentrated fluid product that is intended to be consumed as a beverage only after reconstitution. For the present time, however, the composition standards should be applied to a product in its finished form. A refinement of such standards may be appropriate once there has been an opportunity to evaluate their applicability under actual market conditions.

It should be noted that under the adopted classification provisions accounting for a new product on other than a skim equivalent basis would be limited solely to determining whether or not the product meets the compositions standards of the fluid milk product definition. For all other purposes under the order, the product would be accounted for on a skim equivalent basis. (emphasis added)

In applying the 6.5 percent nonfat milk solids standard, it is intended that this standard apply to such solids in any form except sodium caseinate" (39 FR 8715 – 8716, March 6, 1974)

• • • •

It is clear and specific that the 6.5 percent nonfat milk solids standard is to be applied on a weight basis to the composition of the product in its finished form and not to the composition of the product on a skim equivalent basis. This is an important distinction and is the concept we support. We oppose calculating compliance with the 6.5 percent standard on a milk equivalent basis.

The 1974 decision has not been changed. It has now been the rule for 31 years. These provisions were explicitly reviewed again during the 1998 – 2000 so called Federal Milk Order Reform process and was explicitly reconfirmed in the 1999 final rule.

" 4f. Class I Milk

In this final decision, Class I milk includes all skim milk and butterfat contained in milk products that are intended to be consumed in fluid form as beverages, with certain exceptions. These exceptions include plain or sweetened evaporated or condensed milk, milk that is used in formulas especially prepared for infant feeding or meal replacement if such products are packaged in hermetically-sealed containers, and any product that contains by weight less than 6.5 percent nonfat milk solids." (excerpt from USDA's printed copy of the 1999 final rule)

Retention of these provisions was not inadvertent nor for lack of attention. USDA formed several committees to review certain provisions of Federal orders and made recommendations for the Secretary's consideration. The Federal Order Reform Classification Committee recommended the elimination of the 6.5 percent nonfat milk standard, but it was not adopted, and it was not adopted for good reason. If eliminated it would have left enormous discretion to USDA. The requirement that a product must have at least 6.5 percent nonfat solids provides clear parameters and definition, both very important to a regulatory program such as this.

The 6.5 percent nonfat milk standard is as appropriate today as it was in 1974. It establishes a definitive level of nonfat milk solids that distinguishes which beverages containing milk-derived ingredients are Class I and which are not. It is important, however, that the measurement of whether the 6.5 percent standard has been exceeded continue to be by weight of the finished product. It is a clear and concise rule that can be easily understood and followed. It allows the inclusion of all forms of nonfat milk solids to be measured and included in the determination. It has been proposed that a milk equivalent rule be used to determine whether the nonfat milk solids exceed or fall below the 6.5 percent standard. A milk equivalent rule is complicated, difficult to understand and comprehend and is not as precise. It would exclude some milk components depending on how it is applied or it could double count some components, again depending on how it is computed.

Milk contains many major components and nutrients. Therefore, to calculate milk equivalency when the various components are included in varying amounts in a finished product would double count and overstate the milk equivalency. As an example, if a product contains caseinates, whey isolate, lactose and calcium, and if the standard is based on the amount of milk required to produce the amount of each component in the milk, the milk equivalency could be four times the appropriate amount.

Some of the proposals in the hearing notice would replace the 6.5 percent nonfat solids standard with a protein standard. Companies supporting this testimony are opposed to such a change.

One of the proposals would substitute a 2.25 percent milk protein for the 6.5 percent nonfat milk solids standard. This is not appropriate for several reasons. Some say the two standards are equivalent to each other, but this is not the case. Protein is only one of the components in milk. The 2.25 percent protein standard is equivalent to the amount of protein in skim milk containing 6.5 percent nonfat solids, according to USDA standards for calculating equivalencies. (i.e. Skim milk contains 9.0 percent nonfat solids. 34.44 percent of that 9.0 percent is protein, so the protein in 6.5 percent nonfat solids is 2.25) Using only one nutrient, protein, as the standard provides a significantly different result than using nonfat milk solids.

The 6.5 percent nonfat milk solids standard encompasses all milk-derived components. The standard simply says that if a product contains 6.5 percent or more nonfat milk-derived ingredients it would be Class I, and if less than 6.5 percent it would not. Milk-derived nonfat solids could be composed of any one or more of all the components of milk. They are not required to be in the same portions as they are normally contained in skim milk.

If a 2.25 percent protein standard replaces the nonfat milk solids standard in order to avoid Class I classification the amount of milk protein would be limited to a fairly low level that would qualify as a good source of protein, but products containing 10 grams of protein, the minimum amount required to make a nutrient claim of "high", "rich in", or "excellent source of protein", would be Class I. Using the 6.5 percent nonfat milk solids standard would permit the high protein claims to be made, and would further stimulate the market for concentrated dairy proteins. There is a great deal of experimentation with the use of whey proteins especially in sports drinks. The development of special high protein drinks should be encouraged and not be limited simply because of a regulation inserted in the rules primarily to protect milk against competition from other parts of the beverage industry. Dairy proteins are important components of milk and their use should be strongly encouraged, not discouraged.

The dairy industry has shackled itself with regulations, definitions and multiple restrictions that impede innovation and creation. Innovation and creativity are the foundation for effective competition and competition is the stimulating force of market growth. Leveling the playing field through laws and regulations is the enemy of growth and profitability.

The 6.5 percent nonfat milk solids standard should not be changed and limiting effects of a 2.25 percent milk-derived protein standard should not be included.

Classification of Yogurt and Kefir in Class II

Kefir and yogurt are similar products in that they are fermented by culturing with the use of living microorganisms. [redacted] Kefir, lowfat kefir and nonfat kefir are defined under the cultured milk products section of the Code of Federal Regulations, whereas yogurt has its own standard of identity.

Currently, beverage forms of these products, if they contain 6.5 percent nonfat milk solids are Class I. If they contain less than 6.5 percent nonfat milk solids or if they are not for drinking, they are Class II.

Both yogurt and kefir are often combined with other liquids such as fruit juices, purees, water and other ingredients to provide a specific taste and texture. These mixes are sometimes marketed using the fanciful name "smoothie", and in such cases yogurt or kefir are identified as ingredients, or as a product containing two foods, such as fruit juices and kefir or yogurt.

Cultured dairy products are one of the fastest growing segments of the dairy industry, about 5 percent per year, and yogurt and kefir are anchoring the growth. We believe yogurts that are combined with other foods and water provide and excellent opportunity for dairy farmers to expand the use of dairy ingredients and should not be burdened with the additional costs of Class I classification.

Based on a number of factors, it is clear that drinkable kefir and yogurt are not milk and do not compete with fluid milk. Both have characterizing bacterial cultures that milk does not have, and these cultures have therapeutic benefits to the body such as contributing to gastrointestinal health, improved immunity and lower cholesterol. They are not consumed in lieu of milk or as a substitute for milk. In the case of kefir, it is not bought as a beverage to be consumed with food, but rather as a snack or meal replacement specifically because of the probiotic cultures and the hunger satiation feeling it provides due to its viscosity. These products are frequently not sold in the same section of the store as milk, they have a substantially different texture and taste profile; and are typically packed in containers that are intended to be consumed "on the go" in a single serving. Consumers choose kefir and yogurt culture beverages for different occasions and taste reasons than when consumers elect to purchase fluid milk. In light of these distinct differences, kefir and yogurt should be classified in Class II for all uses.

Replacing the Language "Packaged in Hermetically-sealed Containers" with "Packaged in Containers that are Shelf Stable at Ambient Temperatures"

Proposal number 3 would replace the requirement that special products that are excluded from Class I be "packaged in "hermetically-sealed containers" with new language – "packaged in containers that are shelf stable at ambient temperatures". Virtually all, if not all of the special formulas currently excluded from Class I or proposed for exclusion, are subject to FDA's thermally processed low-acid foods regulations (21 CFR 113). These regulations require all such foods with a finished equilibrium pH greater than 4.6 to be aseptically processed and packaged in hermetically-sealed containers. As a result, we are not certain that the newly proposed language would, in reality, include any packaging material or process not covered by FDA's low acid food regulations. We support continued use of the current criteria that is known terminology and consistent with FDA's terminology and regulations. The only additional products that the new language might apply to are foods (beverages) with a pH of 4.6 or lower that would have sufficient acidity to be outside the low acid food regulations.

Excluding Certain Special Formulas Prepared for Specific Uses

Prior to the 1974 decision on classification, all fluid milk products that were packaged in hermetically sealed glass or can containers were excluded from Class I. In the 1974 decision, USDA changed these provisions and concluded that all fluid milk products whether sterilized or unsterilized should be included in Class I. However, at that time, USDA specifically concluded "*Evaporated milk and condensed milk sold for home use are intended primarily for cooking purposes. They are not consumed normally as a beverage. Infant and dietary formulas, which are being sold in hermetically sealed glass or all-metal containers, are specialized food products prepared for a limited use. Such formulas do not compete with other milk beverages consumed by the general public. Similarly, fluid products containing only a minimal amount of nonfat milk solids are not considered as being in the competitive sphere of the traditional milk beverages.*" *(39 FR 8715)*

The Federal Order Reform rule of 1999 continued the exemption and it now reads, "formulas especially prepared for infant feeding or dietary use (meal replacement) that are packaged in hermetically-sealed containers."

Notwithstanding this long history of classification of meal replacement products in Class II, one of the proposals submitted for the hearing would do away with the specific meal replacement exclusion. There is no basis for doing this. Although we believe the phrase "dietary use" includes meal replacement products such as Slim-Fast, a product of Unilever United States and a party to this testimony, we urge USDA to continue to specify meal replacements as a food exempted from Class I. Slim-Fast products are a true prototype of the "meal replacement" exclusion. Slim-Fast observes the following criteria for the development of its products, each of which reaffirms their identity as a meal replacement, distinct from milk and other beverages:

- Formulated meal replacement products are intended for use as part of a weight control diet;
- When substituted for normal meals, they help maintain adequate nutrition while reducing overall caloric intake;
- Meal replacements are formulated to supply about one third of the daily value for essential vitamins and minerals;
- Meal replacements are formulated to supply at least 20% of the daily value for protein per serving;
- Meal replacements are formulated to supply a good source of fiber; and
- Meal replacement drinks are labeled with instructions that a drink be consumed in place of one or two meals per day.

In many areas outside of milk pricing the law does not treat Slim-Fast as a beverage. For example, of the 11 states that have mandatory bottle deposit laws for beverage containers (which add a deposit amount, usually 5-10¢ per container, that is refundable upon return of the used container, and are intended to reduce solid waste and litter), none require such deposits for Slim-Fast or other similar meal replacement products. Finally, AC Nielsen, which tracks market data for every product sold in a grocery store, tracks Slim-Fast in the Weight Loss Category along with diet pills and other similar product specially formulated to aid in weight loss.

The example of Slim Fast clearly demonstrates the wisdom of the meal replacement exclusion that has been a part of USDA regulations for 31 years, and which should be preserved.

Those companies on whose behalf this testimony is being given support the continuation of the long-standing exemptions for formulas for infant feeding and dietary use (meal replacement). They also support expanding the types of products excluded to not only exclude both dietary uses and meal replacements but specifically identify other types of special formulas that are "specialized food products prepared for a limited use." We suggest that FDA's requirements for foods for special dietary use provide a good framework to discuss this suggestion. Section 411 (c) (3) of the Federal Food, Drug and Cosmetic Act defines "special dietary use" as a particular use for which a food purports or is represented to be used. These divide into three categories which we call --- "clinical", "supplemental", and "sole source".

<u>Clinical</u>
Supplying a special dietary need that exists by reason of a physical, physiological, pathological or other condition, including but not limited to the conditions of disease, convalescence, pregnancy, lactation, infancy, allergic hypersensitivity to food, underweight, overweight, or the need to control the intake of sodium.

<u>Supplemental</u>
Supplying a vitamin, mineral, or other ingredient for use by humans to supplement the diet by increasing the total intake.

<u>Sole Source</u>
Supplying a special dietary need by reason of being a food for use as the sole item of the diet.

Given this regulatory structure, we suggest the following exclusions:

- Formulas especially prepared for infant feeding – a continuation of the current regulations;
- Formulas especially prepared for meal, snack replacement – meal replacements are currently excluded from Class I, and we suggest that snack replacements be added to this phrase. There are an increasing number of dietary recommendations that urge consuming smaller amounts of food at a given eating occasion but consume these smaller amounts more frequently. As a result, many meal replacement products also include items for snacks to replace meals;
- Formulas especially prepared for high protein drinks and have a protein content greater than 10 grams per serving; the level established by FDA in 21 CFR 101.54 (b) that must be met for a product to be called "high protein".
- Beverages that contain alcohol and are licensed by the Federal Tax and Trade Bureau, U.S. Department of the Treasury; and
- Packaged milk products that are specifically formulated and labeled for animal use.

We believe none of these products compete with or would replace sales of fluid milk beverages. They would simply be additive and create opportunities to use additional milk components.

<u>Whey</u>
Whey, a by-product of cheese production, has become a highly versatile source of protein for many foods, some of which are drinkable. Dairy farmers are paid for the milk from which the cheese is made that in turn generates the whey, when it is purchased by the cheese processor. It is unnecessary and inappropriate to try to collect the Class I differential when it is used in various drinks. Many sports drink formulations use whey proteins. These products are highly acidic and contain various juices, water, vitamins and other minerals. Often they do not contain any other dairy component. They are not substitutes for fluid milk

beverages and cannot be considered to be competitive with milk. We believe the appropriate treatment is to exclude whey and whey products from the determination of the 6.5 percent nonfat milk solids standard.

Oppose the Characterization of "Products Containing milk or Milk Products That are Intended to be Used as a Stand-Alone Beverage"

We believe USDA should classify in Class I only specifically defined products, either those that are federally standardized or are otherwise specially identified and defined. However, USDA has, for a number of years, used the undefined and nebulous criteria of "products intended to be consumed as beverages." Beverages are not defined in the actual orders, so the present language allows great latitude and discretion to the officials administering the program.

However, new criteria is being proposed --- "intended to be used as a stand-alone beverage". Although "intended to be used as a beverage" is quite unspecific, the word beverage has a common and usual meaning that has been ascribed to it over time and, of course, is cited in virtually all dictionaries. A "stand-alone beverage" has no history of use or meaning. It is unclear what value is added by the creation of this new terminology, or which products would be captured by it that are not now covered by the current language. We oppose using such an undefined and indefinable criteria.

Conclusion

In conclusion, given the recent trends in sales of Class I milk, we believe USDA's policies should be focused on promoting growth and innovation, especially in terms of new products, within the dairy category. Any efforts to expand the reach of Class I will have the opposite effect, likely prompting reformulation with non-dairy ingredients and driving up the costs of products which new research shows to be increasingly price-sensitive.

We believe the development of new dairy-based products, and those containing dairy-derived ingredients, are not a threat to be met with new regulation, but are in fact an important part of the dairy industry's ability to compete with the alternative beverages over which USDA has no authority. We urge the Department to recognize these forces in the marketplace, and not overreact by increasing the cost and regulatory burden on those trying to bring the benefits of milk, and its components, to consumers through the new products they desire.

Finally, I appreciate the opportunity to appear before you and am happy to answer whatever questions you may have.

Thank you.

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Biographical Information for E. Linwood Tipton

E. Linwood Tipton is the Chairman and Chief Executive Officer of The Tipton Group, Inc., a boutique consulting and lobbying firm located in Washington, DC. His new firm provides consulting, advising and advocating services to its clientele in a wide variety of fields. These include mergers and acquisitions, customs and trade issues, lobbying, management and motivation. The Tipton Group has an exclusive agreement with Rabobank to assist this large Dutch bank in mergers and acquisitions within the dairy industry. Additionally, The Tipton Group, Inc. has joined forces with Prime Consulting Group, a top sales management and merchandising firm, to help dairy companies develop, customize, and implement individual company marketing, sales and merchandising strategies as well as training programs.

Prior to opening his firm on January 1st, 2004, Tip, as he is well known, was President and Chief Executive Officer of the International Dairy Foods Association (IDFA). In this capacity, he was responsible for managing the affairs of four of the nation's top dairy processor organizations – Milk Industry Foundation (MIF), National Cheese Institute (NCI), and the International Ice Cream Association (IICA). Together, the members of these associations operated about 550 plants, employed about 100,000 people, have annual sales of about $40 billion, and use about 75% of the nation's milk supplies to produce the products they sell.

Tipton is widely acclaimed as the driving force that founded the processor-funded generic promotion program famous for the Milk Moustache "got milk?" National *Campaign. After organizing the effort, he was responsible for leading the management* of the program elements from its inception until the end of 2003. He also was responsible for founding two international trade shows, the Worldwide Food Expo, held every other year in Chicago, and Bev Expo, also an every other year show.

Tip chaired an organization representing sugar and sweetener-using industries. He founded the highly successful Sweetener Users Association's annual international conference (International Sweetener Colloquium), which brings about 500 participants from all parts of the world to discuss and debate U.S. and world sugar policy.

He was co-founder, Chairman of the Board and Chief Executive Officer of a restaurant/motel company that operated 30 hotel properties from 1967 until 2000 when the company was sold. Tip trade-marked the Johnny Appleseed Restaurants name and owned and franchised several in the Eastern part of the U.S.

Tip's expertise in international trade issues led to his appointment to the National Commission on Agricultural Trade and Export Policy created by Congress and President Reagan in 1984. He has served as an advisor on trade matters to several U.S.

Addendum to
Biographical Information for
E. Linwood Tipton

Tip has been deeply involved in dairy and agricultural policy issues for many years. He has testified at many Federal milk marketing order hearings, and has worked extensively with multiple groups in developing and pursuing many dairy policy issues including Federal milk marketing order policies.

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